In the Supreme Court
OF THE
United States

OCTOBER TERM, 1940

No.

A. A. NEWHOUSE, J. R. MASON and MARY E. MORRIS,
Petitioners,

vs.

CORCORAN IRRIGATION DISTRICT,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

THE OPINIONS BELOW.

The opinion of the Court of Appeals for the Ninth Circuit appears in the record at R. 364. It is reported. See 114 Fed. (2d) 690. The Merced District case referred to in the decision appears in 114 Fed. (2d) 654.

The opinion of the District Court appears in the record. (R. 364 to 366.) It is reported. See 27 Fed. Supp. 322.

(NOTE): All italics throughout the brief are ours.

II.

STATEMENT OF THE CASE.

We have in the petition given an outline of the case with references and we have shown the points involved. It will be clearer to make the further references under the points argued.

III.

SPECIFICATIONS OF ERRORS.

As required by the rules in the preparation of the statement on appeal, statements of the points relied on were filed. These are set out on pages 352 to 357 of the record and they constitute the errors that were relied on on the appeal.

The argument which follows is presented under separate headings. Immediately following each heading are quoted the points or errors argued under the heading. Where the statement of the points was lengthy and the heading has exactly summarized the points or errors that is explained and the points are referred to by their numbers.

Points 6, 10, 11, 13 and 14 are stated and argued under Point I of this brief.

Pages 27 and 28 hereof.

Points 5, 6, 18 and 18a are stated and argued under Point II of this brief.

Page 59 hereof.

Point 7 is stated and argued under Point III of this brief.

Page 65 hereof.

Points 15 and 16 are stated and argued under Point IV of this brief.

Page 72 hereof.

Point 4 is stated and argued under Point V of this brief.

Page 74 hereof.

ARGUMENT.

I.

AS CONSTRUED HERE SECTION 83 VIOLATES THE 5TH AMENDMENT AND ALSO THE BANKRUPTCY CLAUSE BY DEPRIVING PETITIONERS OF THE SECURITY FOR THEIR BONDS WITHOUT DUE PROCESS OF LAW AND WITHOUT COMPENSATION.

THE WORDS "FAIR AND EQUITABLE" IN SECTION 83 OF THE BANKRUPTCY ACT HAVE BEEN MISCONSTRUED. THE DISTRICT'S PLAN WAS NOT "FAIR AND EQUITABLE" AS IT DEPRIVED THE BONDHOLDERS OF CORCORAN IRRIGATION DISTRICT OF APPROXIMATELY NINE-TENTHS OF THE SECURITY BEHIND THEIR BONDS, WHILE CALIFORNIA LAW MAKES BONDS LEGALLY PERFECT IF THE EQUITY IN THE SECURITY IS BUT 40%. THE DECISION VIOLATES THE DOCTRINE OF THE LOS ANGELES LUMBER PRODUCTS COMPANY CASE.

THE EVIDENCE SHOWED THAT IN THE FIVE YEAR PERIOD OF DEFAULT, THE DISTRICT DID BY LEVYING WATER TOLLS AND A SMALL TAX RATE NOT ONLY CONTRIBUTE FUNDS TO BUY UP ITS BONDS UNDER ITS PLAN (AS STATED IN THE OPINION OF THE COURT OF APPEALS) BUT IT ALSO INCREASED ITS CAPITAL SURPLUS EQUAL TO WHAT WOULD MEET ITS ENTIRE BOND DELINQUENCY OF NEARLY $300,000.00.

Points 6, 10, 11, 13 and 14 which comprise the assignments of error discussed under this heading are (R. 353, 354):

"6. The proceeding takes appellants' rights in their bonds and interferes with their vested rights without due process of law and in violation of the 5th amendment of the United States Constitution."

"10. The district's Plan is unfair in that it grants to the district an excessive reduction in its bonded indebtedness, which deduction is out of all proportion to need."

"11. The Plan proposes to divest the bondholders of their right in security which was adequate for the payment of the obligations of their bonds."

"13. The evidence fails to show any necessity for waiving or cancelling the whole or any part of the debts of the district represented by appellants' bonds. At most the district needed a postponement of time to pay."

"14. The evidence really showed that in the very period when the district claimed it was unable to meet its bond obligations it raised by taxes and water tolls sufficient to meet its bond obligations, or almost sufficient to meet its bond obligations, as they matured."

Preliminarily we have stated that the plan of the district called for a new bonded debt of $484,500.00. (Petition, R. 10.) The final formal contract to purchase new bonds made between the district and the R.F.C. was offered in evidence. This contract referred to Sections 3 to 9 of the California Districts Securities Commission Act which provides that bonds of an irrigation district may be certified as valid investments for savings banks and trusts and even public funds if the margin of security behind the bonds is 40%. We quote from the contract:

"8. Purchase of Bonds:

None of said bonds to be purchased unless they shall have been certified as legal investments by the California Districts Securities Commission pursuant to the provisions of Sections 3 to 9, inclusive, of the California Districts Securities Commission Act," etc.

(R. 222.)

The last paragraph of Section 4 of the Act last referred to reads:

"No bond issue of any district shall be approved for certification as provided in this act which together with any other outstanding bonds of such district including bonds authorized but not sold exceeds *sixty percentum of the aggregate value* of the water, water rights, canals, reservoirs, reservoir sites, irrigation and power works and other property owned by the district or to be acquired or constructed with the proceeds of the bonds proposed to be issued by said district, *and the reasonable value of the lands* within the boundary of the district."

Cal. Stats. 1931, pp. 2263, 2265.

Section 5 provides for the filing of the written report of the Commission with the Controller and Section 8 provides for his certificate which shall be attached to each bond, and show that the bond is "a legal investment for all trust funds and for the funds of all insurance companies, banks, both commercial and savings, trust companies, the state school funds and any funds which may be invested in county, municipal or school district bonds, etc."

Where a corporation defaults on its bonds and presents a plan under 77B it is approved practice for the Court to have an appraisement of the assets of a corporation. In the trial of this case Judge Yankwich obviously felt that an appraisement was necessary. The fact that tax delinquency occurred in this district was common to the tax situation in rural sections throughout the nation. The Courts know that judicially. Tax certificates were, in this district, $14,048.21 at the end of 1929. They were $110,620.57 at the end of 1933. (R. 142, inserted following page 46 hereof.) At the end of 1938 the tax certificates were reduced to $29,598.26. (R. 143.) This was due in part to redemptions and due in part to the fact that tax deeds were made to the district of some of the land which was delinquent. We shall explain fully the sole significance of this tax deeded land and that the total loss represented by taking in this marginal land was comparatively small and was offset many times over by the increase in the capital surplus of the district.

The district temporarily had large tax delinquencies but large tax delinquencies were common at the same time in rural counties. Tax delinquency arises in a large measure from the fact that *the poorer lands* can not bear the full amount of the tax burden but such tax delinquency is not proof that an irrigation district's bonds are not well secured. The testimony in this particular case showed that at the very time that Corcoran Irrigation District was badly delinquent in its taxes, Kings County, in which this district was located, was also badly delinquent in its taxes. But

Kings County is not bankrupt. Mr. Drown, the only witness who testified to this district's so-called bankruptcy, stated (R. 257):

> "A. The county tax rate has remained about the same. But they had big delinquencies too."

The opinion of Judge Yankwich stressed the importance of the showing of great tax delinquency as brought out by questions which he put to the witness. (R. 256 to 257.) But this testimony is not controlling at all in determining the fairness of a plan of composition which involves sacrificing the security which is behind bonds. Delay may be the proper remedy. Judge Yankwich asked:

> "The Court. Are you going to offer any direct testimony other than what is contained in the financial statements, as to land valuations and ability to bear additional taxation?
>
> Mr. Chandler. Except through Mr. Drown.
>
> The Court. All right. I didn't know whether you were going to offer that, because it is customary to do that in these cases."
>
> (R. 248.)

The testimony had shown that the witness Drown was the secretary of the district; that he was a farmer who had owned land in the district since its formation in 1919; that he had prepared the crop reports (R. 124 to 128) which had been furnished to the California Districts Securities Commission in support of an application to levy taxes during the depression below the legal bond service rate. He was the only witness in the case aside from the engineer. The latter testified solely as to the district's water supply. Note the

testimony which the district elected to adduce from Mr. Drown (R. 255):

"Mr. Chandler. Q. Mr. Drown, you have been familiar with the market value of land in the district for some time, have you not?

A. Yes.

Q. And around the year 1929, before the depression came on, what was a fair market value?

A. Oh, a fair market value would be on the good lands around $200.00 an acre.

Q. And do you know what amount of money could have been borrowed in that period prior to 1929?

A. Yes, they were borrowing $100.00 an acre. I borrowed that, myself."

Thus the district vouched for the witness.

The cross-examination first dealt with the financial statements of the district and then it dealt with the market value of the property of the district and of the lands within the district, the very items which are valued by the California Districts Securities Commission in reporting bonds for certification.

These petitioners made the witness their own for the purpose of showing depression valuation of the land of the district and the works of this district.

We quote (R. 259-263):

"A. That's the financial statement.

Q. Financial statement, yes. Taking the last page, there is an item of 94,000 odd dollars, water stock, Peoples Ditch Company, I suppose that is?

A. Yes.

Q. Now, is that the total amount of stock in this complaint that has been purchased by the District?

A. The total amount in dollars and cents.

Q. Well, do this figure in here, 94,000, does that represent the reasonable value of that stock now?

A. Yes.

Q. And is that stock, does that stock entitle the owner to a certain interest in the water rights?

A. It does.

Q. And can that water right be transferred to any other land?

A. Oh, yes.

Mr. Cook. Now, on that same column you have another [203] item of general properties and equipment, 1,131,000 odd dollars?

A. Yes.

Q. What is that item?

A. That item consists of the canal systems, headgates, check gate, weirs, benches, siphons, equipment, real estate, all property.

Q. That includes, for example, the 4000 odd acres of land that you have taken title to?

A. Yes.

Q. Well, at any rate, all I want to know is, your view of——. That's more than the present value of those assets?

A. Oh, yes, it's more than its present actual value, that is, so far as the physical—I don't know what you would call it, physical——

Q. Condition?

A. Condition, yes. Because the headgate and check gate and weirs are all older than they were when they were put in. Some of them have been acquired relatively over the whole period of time, so that they would not all be subject to accumulated depreciation?

A. No.

Q. Would these assets be worth half as much as they are listed there?

A. I would say they would.

Q. Well, there is another item here on your list, and that is assessed value of the District. I find that on the second page it covers the assessed valuation in the last four, the last five years. I notice a drop in the assessed valuation. Is that because of lands that were taken off of the assessment roll?

A. Yes.

Q. Now, this assessed value, while presumably it is the real value, the lands are not really worth the amount of this assessed valuation, are they?

A. No, the average price over the District wouldn't be as much as that.

Q. I think you said this was based on $100.00 an acre in most cases?

A. Yes, we assess all the land at $100.00 an acre with the exception of about 1000 acres, which we assess at $80.00 an acre.

Q. Would you state what the real value is as compared to this [204] assessed value?

A. You mean from a selling standpoint, from a real estate operator's standpoint?

Q. Not a forced sale, but a reasonable value.

The Court. A market value.

Mr. Cook. Reasonable market value.

The Court. The value as determined by a seller who desires or doesn't have to sell, and a buyer who desires but doesn't have to buy.

A. Well, an average over the entire District, in the selling price of the land I don't think it would average over a hundred dollars.

The Court. I didn't get the last part of the answer.

A. I said I don't think it would average over a hundred dollars an acre.

The Court. That means, of course, raw land?

A. Yes. Well, the raw land and the improved land. Take the upper end of the District from the City of Corcoran north, it is very poor. Lands right to the north there sold for twelve and a half an acre this year. And twelve and a half and twenty-five dollars an acre for land north of the District there of the same type as the land in the District.

Mr. Cook. The Judge asked a question, are you speaking of values as they are now with the improvements that are on there now? Of course, your assessment is based upon bare, raw land?

A. Yes. Bare, raw land. And these recent sales there were bare, raw land.

Q. That is, in the northern part, you say the land is poorer?

A. Yes.

Q. Well, can you make, can you state an average for the District, good and bad, and place a value as the Judge indicated in his question?

A. Well, from seventy-five to one hundred dollars an acre.

Q. Well, your answer to that last question, when you say [205] as of the present time, do you also refer to the time when the petition was filed?

A. Yes."

Right at this stage, note that the bond debt was created to supply part only of its water. We quote from Mr. Drown's testimony (R. 303):

"Q. So that practically throughout this entire area within this District of the better land you

have the public irrigation system supplemented with the auxiliary?

A. With the private irrigations."

Also (R. 256):

"Q. Can you tell us the installation cost on an average per acre of these individual pumping plants?

A. Well, depending on the size of the land they would run from $15.00 to probably $25.00 an acre. The deep wells cost maybe more than the shallow wells, but the shallow wells are not such good water."

Note the following from Mr. Holley's testimony (R. 108):

"The District is able to supply only a portion of the requirement of the District.

Q. Where do the farmers receive the remaining water to mature their crops?

A. From individual pumping plants.

Q. Owned by whom, Mr. Holley?

A. Owned by the individual farmers."

There are 28,000 to 30,000 acres of land now being irrigated. Call it 29,000. That times $20 is $580,000.00, paid privately already. That improving is behind these bonds.

Thus the witness Drown valued the assets of the district which appear in the summations of the financial statements of the district for the years 1929 to 1939 inclusive. (R. 142 and 143.) He proceeded to give the value of the tangible assets and water stock owned by the district and he then placed the present depression valuation upon the lands of this district after having

testified on his direct examination that the better lands of the district were in good times worth $200.00 an acre. That the court may have the proper notion in regard to the complaints of some of the California Irrigation Districts as to their debt burden it may be remarked that in some of these cases *the claim is made that the bond debt is as great as the market value of the land in the district. Such was one of the items of testimony in the Imperial Irrigation District case which went before the same Court of Appeals in a proceeding begun under Section 80 and that district merely asked for extension of time and for a scale down in interest for three years.*

There are 51,600 acres of land in this district. (R. 121, 124.) Mr. Drown testified that the land of the district was to be valued at from $75.00 to $100.00 an acre and in our briefs we suggested that one might disregard in the main the valuations which the witness had placed upon the district's works as being valued with the land and we suggested that we should value the land at $87.50 an acre and add to this the large amount of cash which the district had piled up in its treasury in spite of the fact it had been participating in the buying up of its bonds and making capital investments and we suggested that we add also what was invested in water stock which was as good as cash and we had:

51,600 x $87.50 equals	$4,525,000.00	
Cash, two items, $135,609.49 and $70,027.14 or a total of	205,636.63	(R. 143)
Water stock	94,937.29	(R. 143)
Total	$4,825,573.92	

If the water stock is excluded we have a total of $4,730,636.63.

The new bonds will equal $484,500.00. (R. 10, 164.)

This testimony is not escapable on any theory this district was temporarily bankrupt. The per acre debt will be almost trifling in amount. We set out in our briefs what the debt per irrigable acre was upon the lands of various irrigation districts which were or which would be before the same Court of Appeals to have their bonds re-financed. We called attention to page 37 of the official 1934 report of irrigation districts to the State Department of Public Works Bulletin No. 21-F where it is shown that the debt per *irrigable* acre of land within several districts was as follows:

Banta Carbona	$74.84
Corcoran	14.40
Merced	95.24
South San Joaquin	87.36

And we mentioned the astounding fact that Banta Carbona proposes to pay very nearly as much per bond as this district is proposing to pay. It pumps all of its water from the Sacramento River and a great part of it requires two lifts. Merced's offer is called a 50% offer. South San Joaquin is offering almost precisely what this district is offering.

In the following case the United States Supreme Court declared that the provisions requiring that the plan under Section 77B should be "fair and equitable" were "prime conditions".

Tennessee Pub. Co. v. American Nat. Bank, 299 U. S. 18, 22, 81 L. ed. 13, 15.

If so they are prime in Section 83.

> "There is nothing in Section 77B which authorizes a debtor to pay a secured creditor *less than half* the amount of the debt while retaining to its own use a portion of the property securing the debt. * * *"
>
> *Security First Nat. Bank v. Ridge Land & Nav. Co.*, 85 F. (2d) 557, 561, 107 A. L. R. 1240, 32 A. B. R. (U. S.) 97, cert. denied 299 U. S. 613, 81 L. ed. 452, 57 S. Ct. 315.

Speaking of Section 77B, and of a plan of composition *approved by a large majority of the creditors,* the Circuit Court of Appeals for the Second Circuit said:

> "These reasons do not justify requiring the present bondholders to lose their lien to the extent of *50 per cent* and to give up equity in the property, secured by their lien, for the benefit of unsecured creditors. In re Murel Holding Corp., 2 Cir. 75 F. (2d) 941; Gerdes Corp. Reorganizations Vol. 2, sec. 1087."
>
> *In re Day & Meyer, Murray & Young,* 93 F. (2d) 657, 658.

Section 80 followed the pattern of Section 77. When the following case was before it, the Circuit Court of Appeals for the 8th Circuit said the purpose of Section 77 was that:

> "* * * the debtor may live and the creditors will receive *more* than is obtainable upon a liquidation sale."
>
> *Continental Illinois Nat. Bank & T. Co. v. Chicago, R. I. & P. Ry. Co.*, 62 F. (2d) 451.

Of composition legislation the following case states:

> "Viewed practically, it was legislation for the purpose of promoting for the creditors of full, *or better,* realization of their claims than would occur through immediate liquidation."
>
> *In re Prima Co.,* 88 F. (2d) 785, 789.

When this district quit paying, it was confronted with three things:

(a) a program of capital expenditures.

(b) the depression.

(c) bond principal maturities and as we have pointed out it borrowed to pay on its bonds. But it borrowed less than it was putting into capital investment.

It could not show it was insolvent; really did not show true bankruptcy.

The purpose of composition is to avoid settlements which limit an offer to depression valuations. As we have stated, the valuation placed on the land within the district was the valuation of the depression years. *The following cases show that this rule is unduly severe as to creditors.*

See Point 4 in opinion in following case:

In re Gibson Hotels, 24 Fed. Supp. 859.

See Point 5 in opinion by Judge Sanborn in the following case:

Central States Life Ins. Co. v. Koplar, 85 F. (2d) 181 (8th Ct.).

The following case also shows this rule:

Central States Life Ins. Co. v. Koplar, 85 F. (2d) 181.

The following case indicates that the rights of creditors should by virtue of the composition provisions of Section 77B be considered as having *a greater value* than what might be obtained through liquidation; that the creditors have a right to have the going value of the corporation's business taken into consideration.

In re Dutch Woodcraft Shops, 14 F. Supp. 467 at p. 469.

And where value is being tested by use or yield of income it is not proper to determine the value solely by yield during depression years.

In re Georgian Hotel Corp., 82 F. (2d) 917, Cert. denied 298 U. S. 673, 80 L. ed. 1395.

That applies to the ex-parte crop reports made by this district to the state Securities Commission.

To hold that a district having land worth about $87.50 an acre and having its irrigable land already improved with private water systems is entitled to have its bonded debt cut to less than $10.00 is unreasonable. As suggested, apply the surplus cash which was piled up in this district's treasury, while it was claiming it could pay its bondholders nothing and while investing in its own bonds and the burden almost reaches the vanishing point.

The statement in the opinion of the Circuit Court of Appeals that our contention was that the district had while defaulting raised funds to help buy its own bonds is, we say respectfully, a most unfair construction of our contention and the evidence. We showed

that this district had in the five year period of its default following January 1, 1934 raised not only $62,437.02 to buy up its own bonds, but we showed by uncontradicted and unmentioned evidence that it had placed in capital investments an amount that exceeded the whole amount due on delinquent interest coupons extending over a five year period and amounting to $197,104.78, but that it also increased its capital surplus $91,698.20, not counting at all the $62,437.02, and the total of the last two items was far above the principal that matured on the district's bonds or $103,000.00. It does not take an expert accountant to understand the evidence. It is perfectly clear and simple.

We say respectfully that we went far enough when we proved that—judged by depression valuation—the plan required throwing away about 9/10ths of the security. We had a right to stop there and to contend that the most this district needed was delay. We provided the very kind of proof used in certifying bonds as investment for savings banks and trusts.

It is not extravagant to say that if this district could on the showing made have its debt practically halved financing of irrigation districts in California ought to be at an end. All such bonds are imperiled.

In keeping with California law (Sec. 14a Cal. Stats. 1917, p. 756) the district issued financial statements annually and showed therein assets and liabilities at the end of each year segregated in the following items:

Assets: Cash; Fed. Res. Bank Escrow; Gen. Prop. & Equip.; Water Stock P. D. Co.; First

Inst. Taxes; Second Inst. Taxes; Penalties & Costs; Tax Certificates.

Liabilities: Bonds outstanding; 7% warrants outstanding; Unpaid coupons; Cont. Obligations; Bal. of assessment; Capital surplus.

Of course, comparison of Capital Surplus at the end of succeeding years tells the story as to how the district is running, if items are not omitted. It was conceded that the item of investment in the district's own bonds was omitted. *In other words the district carried the bonds in liabilities at the full face value.*

These financial statements for the years 1929 to 1939 became the third and fourth pages of Petitioner's Exhibit No. 7, the first two pages of the exhibit being the itemized cash receipts and disbursements of the district for the period. The Exhibit comprises four sheets, R. 140, 141, 142 and 143 and we shall, to save work, insert pages 142 and 143, following page 46 hereof. In so doing we shall italicize figures to which particular reference is made.

If in each year after 1933, when the district quit paying bond interest, the whole of bond debt, counting accumulated interest, is set down in liabilities and still surplus is increased, there is but one conclusion: The district has been increasing its capital in excess of its bond debt including all bond delinquency.

Note the pages of the record, R. 142 and 143, which we insert, following page 46 hereof. Start with the end of 1933 and then look at the end of 1938. We have:

1933 Capital Surplus	$439,469.91 (R. 142)
1938 Capital Surplus	531,168.11 (R. 143)
Increase	$ 91,698.20

(In stating liabilities this district adopted the practice of repeating in liabilities the total unpaid on the last annual installment of taxes, thus exactly offsetting the corresponding item in assets. The entry on both sides of the account does not affect the net result. It is like giving an asset and saying it will be soon absorbed by expense.)

Looking at R. 141, containing the district's disbursements for 1937 and 1938 we have the two items spent in buying up bonds:

	1937	1938
Bondholders account refinancing	$59,674.32	$2,762.70

The total is $62,437.02. It was of course proper to put in liabilities all the unpaid bonds and also all interest unpaid, but it was not correct to ignore the fact that the district had invested funds in its own bonds. That the district was rendering statements not properly qualified on this point became immediately evident on comparing the increase in "Gen. Prop. & Equipment" in the year of greatest expenditure on the bond purchase. Turn to R. 143 and we find "Gen. Prop. & Equipment" at the end of 1936 is $1,044,538.72 and at the end of 1937 it is $1,090,698.70 and the difference is but $46,109.98. But when we turn to R. 141 we find that the district in 1937 put in what it called "Bondholders account Refinancing," $59,-

674.32 and in addition spent on "Refinancing Exp.," $4,162.53. *In other words what was spent on bonds is not in the addition to the Property account.* So it was not denied that this district was treating the bonds taken up as owned by the R. F. C. *That is what it alleged in its petition.* We shall quote from the testimony of the Secretary of the district showing that what he classed as capital investment for 1937 and 1938 consisted of improvements. But still we have the increase in Capital Surplus of $91,698.20 after putting the bonds in liabilities at face or $733,000.00 and all coupons in default or $197,104.78. (R. 143, inserted.)

Thus the increase in Capital Surplus as actually given and uncorrected almost equalled the bonds matured amounting to $103,000.00. (R. 143.) If *the R. F. C. was made the owner of the bonds taken up in part with the district's money, that does not weaken the argument as to what this district raised* in the 5-year period of bond default.

We stress that without adding the investment in bonds amounting to $62,437.02, the district increased its surplus by $91,698.20.

When we add the two sums, we have:

Increase in surplus	$91,698.20
In buying a share on the bonds	62,437.02
Total	$154,135.22

Bonds maturing in the five years equalled but $103,000.00. (See R. 143.) Keep in mind that the Circuit Court of Appeals did not note *that accumulated in-*

terest of $197,104.78 is in the liabilities; that all that sum and far more was raised.

In other words, the true increase in surplus, after charging in liabilities bond coupons in the sum of $197,104.78 (see p. 143), *exceeded the maturities on the principal.* But even if the capacity was simply to pay the carrying charges, it would be unjust to grant more than delay.

At the bottom of R. 143 and to make the picture bad, the district made an estimate of matured bonds and coupons and interest thereon. It is not a fair test. The district's funds were diverted to capital investment and surplus cash and fairness would call for saying that if the district had not preferred itself, there could have been no compounding of interest. Note the pile of cash in the upper right hand corner of R. 143. (Inserted.) It is given in two items.

And what is the showing? It is that the delinquency was $6.88 an acre. How about the other cases which we believe will come to this court, in which this figure will be between $30.00 and $40.00 an acre where there was no increase in capital at all.

Pages 142 and 143 of the record follow:

FINANCI

CORCORAN IR

YEARS ENDI

ASSETS	1929		1930	
Cash		55,579.55		58,918.9
Gen. Prop. & Equip.		996,864.41		1,002,469.4
Water Stock P. D. Co.		20,133.13		45,315.5
First Instl. Taxes	4,522.01		22,753.21	
Second " "	51,773.28		70,961.93	
Penalties & Costs	452.15	56,747.44	2,275.33	95,990.4
Tax Certificates		14,048.21		21,759.3
		$1,143,372.74		$1,224,453.0

LIABILITIES	1929		1930	
Bonds Outstanding	760,000.00		760,000.00	
7% Warrants	58,666.68		55,166.70	
Unpaid Coupons	210.00		330.00	
Contract Obligations	0		0	
Recording Fees	.25	818,876.93	0	815,496.
Balance of Assessment		56,747.44		95,990.
Capital Surplus		267,748.37		312,966.
		$1,143,372.74		$1,224,453

BOND AND I

Un-Paid Matured Bonds 1929	0	1930	0
Un-Paid Matured Coupons "	0	"	0

FINANCIAL STATEMENTS

CORCORAN IRRIGATION DISTRICT

YEARS ENDING DECEMBER 31st

1929		1930		1931		1932		1933	
	55,579.55		58,918.93		46,904.53		28,856.50		*29,678.95*
	996,864.41		1,002,469.41		1,006,927.76		1,005,938.05		1,007,067.85
	20,133.13		45,315.54		54,074,074.31		81,197.42		86,197.42
4,522.01		22,753.21		23,442.20		23,125.43		17,016.02	
51,773.28		70,961.93		39,768.06		39,700.02		37,245.72	
452.15	56,747.44	2,275.33	95,990.47	2,286.34	65,496.60	2,312.51	65,137.96	1,701.74	55,963.48
	14,048.21		21,759.33		47,027.71		73,386.87		110,620.57
	$1,143,372.74		$1,224,453.68		$1,220,420.91		$1,254,516.80		$1,289,528.27

1929		1930		1931		1932		1933	
760,000.00		760,000.00		750,000.00		740,000.00		733,000.00	
58,666.68		55,166.70		31,459.96		18,673.67		22,925.22	
210.00		330.00		150.00		120.00		17,910.00	
0		0		0		17,759.66		20,259.66	
.25	818,876.93	0	815,496.70	0	781,609.96	0	776,553.33	0	794,094.00
	56,747.44		95,990.47		65,496.60		65,137.96		55,963.48
	267,748.37		312,966.51		373,317.35		412,825.51		*439,469.91*
	$1,143,372.74		$1,224,453.68		$1,220,420.91		$1,254,516.00		$1,289,528.27

BOND AND INTEREST DEFAULT

	0	1930	0	1931	0	1932	0	1933	$ 3,000.00
	0	"	0	"	0	"	0	"	0

FINANCIAL STATEMENTS
CORCORAN IRRIGATION DISTRICT
YEARS ENDING DECEMBER 31st

ASSETS	1934		1935		1936	
Cash		36,490.73		90,757.04		142
Fed. Res. Bank Escrow						
Gen. Prop. & Equip.		999,137.18		1,010,976.34		1,044
Water Stock P. D. Co.		90,402.42		92,921.16		94
First Inst. Taxes	21,204.49		10,715.68		12,522.14	
Second " "	29,578.79		37,031.94		48,328.12	
Penalties & Costs	2,120.45	52,903.73	1,071.68	48,819.30	1,255.22	62
Tax Certificates		$ 128,504.88		$ 121,437.52		122
Totals		$1,307,438.94		$1,364,911.36		$1,465

LIABILITIES	1934		1935		1936	
Bonds Outstanding	733,000.00		733,000.00		733,000.00	
7% Warrants	14,544.42		2,609.29		2,609.29	
Unpaid Coupons	45,000.00		86,490.00		128,700.00	
Cont. Obligations	20,095.78	812,650.20	22,387.08	844,486.37	8,813.70	873,
Bal. of Assessment		52,903.73		48,819.30		62,
Capital Surplus		441,885.01		471,605.69		530,
Totals		$1,307,438.94		$1,364,911.36		$1,465,

BOND & INTEREST DEFAULT

Unpaid Matured Bonds 1934	13,000.00	1935	23,000.00	1936	43,(
Unpaid Matured Coupons	12,304.78		55,204.78		97,3
Unpaid Matured Bonds 1939	103,000.00				
Unpaid Matured Coupons	197,104.78				
	44,509.58				
Total default Jan. 1, 1939	344,614.36	Accrued interest on matured bonds & coupons (estimat			
		Equal to $6.88 per acre over district.			

TS

STRICT

R 31st

1936		1937		1938
142,229.07		108,215.95		*135,609.49*
		72,789.84		*70,027.14*
1,044,528.72		1,090,698.70		1,131.100.71
94,493.66		94,937.29		94,937.29
	3,931.00		2,054.83	
	31,730.25		23,683.25	
62,135.48	393.12	36,054.37	205.56	25,943.64
122,176.96		57,102.09		29,598.26
$1,465,563.89		$1,495,798.24		$1,487,216.53

936		1937		1938
	733,000.00		*733,000.00*	
	0		0	
	155,280.00		*197,104.78*	
873,122.99	5,288.22	893,568.22	0	930,104.78
62,135.48		36,054.37		25,943.64
530,305.42		530,175.65		*531,168.11*
$1,465,563.89		$1,495,798.24		$1,487,216.53

ULT

43,000.00	1937	63,000.00	1938	83,000.00
97,204.78		138,004.78		177,604.78

(estimated at 7%)

In our briefs we made careful references to the cash disbursement sheets R. 140 and R. 141 covering the 5 year period and we showed items in the nature of capital expenditures and then added these to the increase in cash which had piled up in the treasury and which *increase* amounted to $175,958.68. We made an aggregate of items of $482,329.80—items of the kind that suggest capital investments.

We now insert our schedule of those expenditures. We are not contending that all the items represent strictly a capital investment. But the slightest glance at the schedule shows what this district did with its funds while paying nothing on its bonds. (The first items of bond interest which we enter is old interest paid in full under the plan. Warrants redeemed are the loan warrants which we have referred to. At the bottom are entered interest payments to the R.F.C. in 1937 and 1938. Everything is paid as per contract excepting the part of a bond debt singled out five years before.)

SCHEDULE MADE FROM R. 141

	1934	1935	1936	1937	1938
Contracts and Int.	$ 2,133.78	$11,102.91	$ 1,403.30	$ 3,525.48	
Bondholders Account Refinancing				59,674.32	$ 2,672.70
Bond Interest	16,510.07	820.05	1,007.84	16.73	
Warrants Redeemed	8,370.80	11,945.13		2,609.29	
Warrant interest	1,376.48	686.54		420.84	
Assessments on water stock	5,833.55	5,940.05	7,832.05	17,165.66	6,069.02
Refinancing expenses	2,939.78	4,181.95	4,841.85	4,162.53	1,602.58
Capital expenditures	11,649.26	10,556.34	30,395.78	22,385.65	15,013.59
Totals	$48,813.72	$45,232.97	$45,480.82	$109,960.50	$ 25,447.89

The total of the foregoing disbursements is	$274,935.90	
Cash on hand increased during the five-year period (comparing "cash", end of R. 142, with end of R. 143)	175,958.68	
Total	$450,894.58	
Interest to R. F. C. (1937)	13,967.81	(R. 142)
Interest to R. F. C. (1938)	17,467.41	(R. 141)
Total	$482,329.80	

It could be urged that the assessments on the water stock owned by the company were current. They could be thrown out for all of the years except perhaps for 1937 in which year they are entirely out of line. We prepared the schedule to corroborate what is conceded in the annual financial statements. Probably not a single item excepting assessments of the water company in which the district owned stock represented "Maintenance & Operation". The first item in the schedule "Contracts and Interest" could be thrown out entirely. But we showed it related to a bill of Fairbanks-Morse for pumping machinery. (R. 291.)

Skip all debt paying and what did this district invest in this five-year period? We have:

Contracts and Interest	$ 17,728.69
Bondholders Account, Refinancing	62,437.02
Refinancing expenses	17,728.69
Capital expenditures, entered as such	90,000.62
Increase in cash	175,958.68
Total	$363,853.70

The item of $175,958.68 is increase in cash—arrived at by comparing the cash at the end of R. 142 with *the two items* of cash at the end of R. 143 covering a five-year period of default. This was over $150,000.00 above what this district ever normally carried over to the ensuing year.

The court could throw out the whole schedule and consider merely the increase in cash and we would have a sum that is not very far from the delinquent bond interest shown in the financial statement as amounting to $197,104.78.

The last five years were what Mr. Drown stated was the worst possible five years in the life of the district. The tax levies were very low but water tolls raised substantial amounts. That was a perfectly legitimate process of obtaining revenue and it is of course a conceded fact that in the five-year period annual tax delinquencies decreased greatly. (Bottom of R. 140 and 141.) We quote from the testimony of Mr. Drown:

"Q. You've got that cash on hand and you have been raising a great deal of cash through

these tax levies and water tolls? That's right, isn't it?

A. Yes."

(R. 323.)

"* * * Now, those people that use water pay the water tolls in addition to the regular assessments.

Q. Yes, they pay the assessments.

A. That's where the people who have had the benefit of the use of the water, pay more into the District than the people who do not."

(R. 329.)

The court must remember that this district claims that it can bear a bond debt of only $484,500.00 bearing interest at 4% per annum; that interest on this sum is but $19,380.00 a year and that there are 57,600 acres of land in the district.

The Irrigation District Act of 1897 has always provided that the whole of general expenses may be raised by water tolls.

Sec. 55, Act of 1897, Cal. Stats. 1897, p. 273.

Willard v. Glenn-Colusa Irr. Dist., 201 Cal. 726 at p. 739, 258 Pac. 959.

We have mentioned that when in the preceding five years—1929 to 1933—this district was borrowing through issuing warrants it was increasing Capital Surplus, putting more into capital than it borrowed. In fact, if we but take the first item of Capital Surplus on R. 142 and the last item on R. 143 we have:

Capital Surplus end of 1929	$267,748.37
Capital Surplus end of 1938	531,168.11
Increase	$263,419.74
Adding investment in bonds	62,437.02
Gives	$325,856.76

This is increase in spite of putting in liabilities the whole accumulated bond interest delinquency.

We take up again the last five years—the worst in the district's history.

On further cross-examination the witness, Drown, answered (R. 322-324):

"Q. Then in this sheet you have entered for the year 1938, in the very last column on the last page, as a liability of this District $197,104.78, and that represents unpaid coupons, doesn't it?

A. Yes, unpaid coupons.

Q. In that figure there are not included the coupons which were paid in the settlement with the R.F.C.?

A. No. That's eliminated." (He is referring to the fact that the R.F.C. sent in coupons equal to its interest bill after it began advancing in 1937.)

"Q. Now, isn't it a fact that after charging all of these coupons as being unpaid, and which aggregate $197,104.78, your capital surplus increased by the sum of $89,283.10? That's true, isn't it?" (We inadvertently referred to the end of 1934 instead of the beginning. The figure should have been $91,698.20. See ends of R. 142 and 143.)

"A. Well, I haven't figured the arithmetic.

Q. Well, now, what I am getting at is this: According to your own books, your capital surplus has increased $89,000. plus, notwithstanding that you have charged as unpaid the whole of the unpaid coupons that have accumulated during the period of your default. That's right, isn't it?

A. Well, they are not capital surplus.

Q. But they are charged against assets?

A. They are charged against assets.

Q. In determining your surplus?

A. Yes.

Q. You've got that cash on hand and you have been raising a great deal of cash through these tax levies and water tolls? That's right, isn't it?

A. Yes.

Q. Now, isn't it a fact that the unpaid coupons which you have entered on this sheet, when added to the increase of capital assets as shown on this sheet, practically equal every dollar that would have been paid on the old bond issue if you had met every installment of principal and interest?

A. I don't think so.

Q. Well, have you made no computation to test that?

A. No, I haven't.

Q. Now, let me ask you this: This sheet here—I'm a little bit unclear as to years, but this last page of the petitioner's exhibit number 7, does it depict your financial condition as of December 31, 1938?

A. It does.

Q. Then this means that the 4% interest obligation has been cleaned up, up to and including the January 1, 1939 payment to the R.F.C.?

A. Just a minute, now, and we'll see. Yes, we paid the R.F.C. interest $17,467.41."

Referring to the R.F.C. interest bill for the period from January 1, 1939 to July 1, 1939, he stated (R. 324, bottom of page):

"Q. These came in early and you paid the $17,467.00, didn't you?

A. Yes.

Q. So that the financial statement let you start off, so far as 4% of the interest is concerned, with that paid until next July 1, 1939?

A. Yes."

Mr. Drown further testified (R. 149, 150):

"These statements show that we have built up our surplus from a figure of $439,000.00 plus in 1933 to a figure of $531,000.00 plus.

Q. In other words, your financial condition as reflected by the financial statement in the year when the petition in this case was filed, was entirely different from what it was in the year when you went into default on the paying of your coupons?

A. Oh, yes, sure.

Q. It has decidedly improved?

A. Decidedly improved, yes.

Q. And it has continued to improve, according to these statements, since you filed the petition in this case. Is that right?

A. Yes.

Q. In other words, if one looks at your capital asset statement, general property and equipment, you find that today in 1938, you have a set-up of $1,131,100.51. Is that correct?

A. Yes.

Q. You, in the year '37-'38, that is, counting a year represented by those two statements for '37 and '38, you put $50,000.00 into capital investment, didn't you, approximately?

A. Yes.

Q. What was that $50,000.00?

A. Five wells and pumping plants and improvements, meter gates and stuff of that kind."

(R. 149, 150.)

According to the letter dated December 5, 1936, sent by Hankins and Hankins, then attorneys for the district, to the R.F.C., this district paid, in the two years 1934 and 1935 on the old warrants and on the bond delinquency which it excluded from the settlement, the two items of $28,391.13 and $24,554.63.

(R. 282.)

Note what Messrs. Hankins and Hankins call "Betterments and Probable Additional Sources of Income":

On contract to buy water stock, they paid..$14,825.32

And during the year 1936, "capital investments was increased" by new wells and pumping plants..... 24,221.29

(R. 279.)

The affidavit of Mr. Hansen, president, and Mr. Drown, secretary, made January 29, 1927 (R. 285-6) and sent to the R.F.C., shows:

"That they are familiar with the physical condition of the project of the above District;

That all parts of said project are in good physical condition and *no replacements or repairs*

are necessary, other than the usual upkeep and maintenance, except as follows:

No exceptions."

(R. 285.)

And the affidavit concludes:

"District has purchased equivalent of 98/100 of a share of Peoples Ditch Stock at a cost of $8,633.00 and drilled five (5) new wells at a cost of $24,290.50."

(R. 285.)

It is of course obvious that the district did not, in determining its percentage of tax delinquency, take into consideration as a part of the total tax, the water tolls.

Speaking of the five years of default the witness Drown testified (R. 330):

"Q. Now let me ask you a question. You couldn't have had a worse series of years could you, than you have been having in the last five or six?

A. I don't think so."

That men do not make money on good land for a series of years is no excuse for taking it out on those who lent the money to improve the land—unless it can be shown the value is not there.

As we explained in our briefs below, there is but one conceivable argument against these figures—*the possibility that tax deeded land as carried in the assets is worth less than the price at which it went to*

the district. In judging this tax-deeded land, the court will at least consider that all districts have some tax-deeded marginal land even in comparatively good times. The law recognizes that some land in a large body will be slow paying in normal times. It requires that assessments must be levied in an irrigation district on the theory that there will be temporary delinquencies of 15%.

Sec. 60, Cal. Stats. 1919, p. 669.

Aside from the fact that all the land was considered in the valuation testimony, the evidence clearly showed this deeded land had value. It had survived years of assessing.

We refer again to certain testimony of Mr. Drown, secretary of the district.

R. 122. He states that the amount of tax-deeded land is 4701.23 acres.

R. 144-5. He explains that the fact that the percentages of delinquencies are reduced as indicated at the bottom of R. 140 and R. 141 does not mean that they have been reduced to the full extent specified because when the district takes a deed after the land has been delinquent for the permissible legal period of three years the amount assessed against that land is taken out of the amount delinquent *and added to Property,* etc.

R. 260. He states that the tax-deeded land goes into the statement of capital and hence reduces the delinquency total.

R. 147. The witness explains that the delinquent land is first represented by a tax certificate and that these at present are $29,598.26. We next quote the bottom of page R. 264:

> "In 1929 we had $14,048.21 in tax certificates on the books. That's page 3. The total, now, is $29,598.26. The land that we have taken title to is included in general properties and equipment. We sold about 1590 acres of land. *We sold it for delinquent taxes, penalties and costs, and 9% interest from date of sale, with the exception of two or three cases that had so much on it we sold it for $10.00 an acre.* We still have a quantity of land. Some of it is saleable. That is, we would sell it if somebody wanted to buy it. We have calls for it occasionally. I've got a call right now for 20 acres. The land was taken in for around fifteen, eighteen, twenty dollars an acre."
>
> (R. 147.)

Now note what he says this land was taken in at. The price was from $15.00 to $20.00 an acre. Call it $17.50.

R. 122. The tax-deeded land is 4701.23 acres.

Multiplying the 4701.23 by $17.50 we have $82,271.53.

Now the witness claimed that this body of land began to come into the Financial Statements in 1934, and then he gave the rentals therefrom. (R. 148.) Summarizing this we have:

1934 rentals were	$ 378.74
1935 rentals were	1134.42
1936 rentals were	1815.66

1937 rentals were	4538.80
1938 rentals were	3490.29

The fact is this land became free of all other taxes when it was deeded to the district and until it was resold.

Anderson-Cottonwood Irr. Dist. v. Klukkert, 13 Cal. (2d) 191, 88 Pac. (2d) 685.

So it is perfectly apparent that these tax-deeded lands do not, either in the holding or selling of the same, represent dead loss. *Cut the price one-half and the figure is less than what the district invested in its own bonds.*

We say respectfully that it was only by overlooking the evidence and overruling the rule of the *Los Angeles Products Company* case that the learned Circuit Court of Appeals upheld this case. Yet it reversed the *Fano* case. There, without discussing "fair and equitable", it held what is stated in the first syllabus of the opinion. The effort was to cut the bond debt to 62.50% of principal. We contend the same court in effect there held that disregarding the value of security for bonds is not permissible because of mere bankruptcy. We quote said first syllabus:

> "An irrigation district organized under California law was not 'insolvent' in a bankruptcy sense when it filed petition under bankruptcy act on November 11, 1937, where $15,000 deficit on accrued interest on district bonds as shown by district's financial statement of December 31, was caused by reconstruction of irrigation system and diversion of tax moneys to payment therefor and district owned debt free, except for

interest, assets which were in excellent condition and of a value which greatly exceeded amount of district's indebtedness."

Fano v. Newport Heights Irr. Dist., 114 Fed. (2d) 563.

II.

SECTION 83 IS UNCONSTITUTIONAL IN ITS APPLICATION HERE. THE PLAN CHARGED THE WHOLE BURDEN OF ACCORDING RELIEF TO THE BONDHOLDERS ALLOWING TAXING FOR BONDS OF OVERLAPPING TAXING AGENCIES AND ALL PRIVATE MORTGAGES TO REMAIN UNREDUCED.

Points 5 and 6 in the statement of points (R. 353) and points 18 and 18(a) (R. 355-356) are a lengthy statement in a different form of precisely what is set out in the foregoing heading.

Section 83 should not permit a political subdivision to destroy its bondholders by reducing the tax lien which secures its bonds while leaving unaffected the tax rates or liens of other political subdivisions. Section 83 is unconstitutional in its application here because it contained no provision for bringing in taxing agencies or bondholders of other taxing agencies which overlap this district. That a law may be unconstitutional in a particular case is clear.

Nashville, C. & St. L. R. Co. v. Waters, 294 U. S. 405, 415, 79 L. ed. 949, 955;

Yick Wo v. Hopkins, 118 U. S. 356, 30 L. ed. 220, 227.

We offered an exhibit showing over-lapping bond "liens" of other taxing districts, which likewise levy

their taxes on the lands in this district on an ad valorem basis. (R. 298.)

Every acre of the district is in a bonded school district. (R. 300 at 301.) The tax liens of those districts are but on a parity with those of the irrigation district.

LaMesa, etc., Irr. Dist. v. Hornbeck, 216 Cal. 730, 17 Pac. (2d) 143.

Referring to Section 3787 of the Pol. Code, which at one time made county taxes superior to irrigation taxes, it is to be noted that in 1917, which was prior to the issuance of these bonds, the tax deed for state and county taxes was placed on a parity with the irrigation act deed.

> "Later, and in 1917, this section was again amended so as to except not only a lien for municipal purposes *but for irrigation district purposes as well.* Later, and in 1927 (Stats. 1927, p. 1666) the section was again amended so as to specially except a lien for reclamation, protection, flood control, public utility and other district purposes. This section has been construed by our own appellate court and by the Supreme Court of at least one other state which has enacted it into their law, from which it is concluded that the legislative intent is to place all taxes, both for county, municipal and other governmental agency purposes and taxes in the form of assessments in favor of special agencies of the state *upon an equal footing before the law.* (Bolton v. Terra Bella Irr. Dist., 106 Cal. App. 313 (289 Pac. 678); State v. Board of Commrs., supra.)

> From the above authority and upon our construction of the section we may now safely conclude that under our system of taxation *liens* in favor of county and municipal corporations and special assessments, under the authority of state agencies for public purposes, *are all on an equality.* * * *"
>
> *LaMesa etc. Irr. Dist. v. Hornbeck,* 216 Cal. 730, 736, 737, 17 Pac. (2d) 143.

School district taxes are levied in lump sums with general county taxes.

School Code, Section 4.372;
Cal. Stats. 1931, p. 2493.

Exhibit D (R. 298) shows in the right hand column the percentage of overlapping bond liens of the other political subdivisions. They are:

Kings County	$ 1,250.00
Corcoran High School District	63,560.00
Hanford High School District	1,500.00
Corcoran Elementary District	3,400.00
Reclamation District No. 749	4,400.00
Total	$74,110.00

The plan did not consider the tax burden of these districts at all. They are agencies of the same sovereign mentioned in Section 81 of the Act. Sections 81 to 83 say: Treat the land as a debtor. But a levee district can be in an irrigation district and either can be in a reclamation district and either such district may contain the whole of or a part of a school district. What plain discrimination it is to destroy

the right of one bond against the land while leaving another bond unaffected although issued by an agency of the same sovereign for the same purpose—any public purpose.

Clearly this district's debt could have been reduced less if Section 83 permitted lowering the taxes of these other districts.

Assuming the *Bekins* case is right on the facts, it does not say the state and the federal government can use the bankruptcy power as it was used here. That case was made out by the petition and a motion to dismiss it.

The bankruptcy power does not permit discrimination. In justifying a limit upon the claim which a landlord could make in bankruptcy under Section 77B(10), the Supreme Court took pains to point out that, *because of the nature of the claim,* the possibility of re-renting at a figure higher than estimated, no true discrimination resulted. Of the remedy, it said:

> "We are unable to say that that which Congress did select so *discriminates* between individual claimants to the detriment of the petitioners as to render it unconstitutional as to them."
>
> *Kuehner v. Irving Trust Co.,* 299 U. S. 445, 456, 81 L. ed. 340, 347.

Evidently the 5th amendment prohibits this plain discrimination. It is not within bankruptcy power.

It is shocking that Section 83 is so carelessly worded that it did not provide for treating all creditors alike. It starts out by treating the landowners within a

particular political subdivision as being debtors to the extent of the land. It then proceeds to sacrifice the interests of particular creditors having claims against the lands which claims were created by the same principal, paying utterly no attention to the fact that by cutting down the particular bond issue and tax rate involved it is indirectly discriminating in favor of other claims created by the same principal—claims that rank the same under state law. The land is treated as bankrupt and the whole loss is thrown on a few who received their bonds under a law that promised equality. The irrigation district has an assessment roll just as the county has and levies its taxes on land as does the county and as we have shown the tax liens are on a parity in California.

Be practical, says the district. How can the very purpose of fairness be accomplished when part only of the creditors are compelled to bear the entire loss.

And what a blessing for private mortgagees. Not a word in Section 83, that permits making them reduce their loans to help out the petitioning landowners. A mere private inferior lien is simply elevated at the expense of the dissenters who are called Shylocks and made the victims of an unreasoning sacrifice. The uncontradicted oral testimony was that there were plenty of mortgages on the lands in the district and the Circuit Court of Appeals recognizes this. We quote from Mr. Drown's testimony (R. 155, 156):

> "Q. * * * Of course, discharging this bonded indebtedness is a very fine thing for the mortgage holder, isn't it?

A. Oh—I don't know whether it is or not. I'll tell you: Mortgage holders advance money to take up delinquent taxes.

Q. Well, that, you found, occurred, then, in this District in a substantial degree?

A. Yes.

Q. That mortgage holders were in the habit of advancing money to take care of taxes upon mortgaged land?

A. To protect their interest.

Q. Beg your pardon?

A. To protect their interest.

Q. And is that still being done within the District to some extent?

A. Yes.

Q. That is, mortgagees abstain from foreclosure because the owner is finding difficulty in carrying the load, is that right?

A. That's right. And they advance the money and charge it.

The Court. I could make additional note of the fact the ordinary mortgage in California gives the mortgagor the right to advance money on the indebtedness. All the banking mortgages so provide that if they fail to pay the taxes it shall be added to the indebtedness.

Mr. Clark. Q. You found that the mortgagee or renters were pretty anxious to put this scheme through, didn't you?

A. I never contacted any of them at all. What I figured out in that connection, Mr. Clark, was this: That the District is entitled to tack a dollar to the land when the land is delinquent three years.

Q. Yes?

A. And when we take that dollar it wipes the mortgage off the slate.

Q. Yes?

A. Those people, to protect their interest, advance the money, take up the tax and add it to the mortgage."

What of logic which says that it is fair to excuse this plan of composition because of mortgages. The Irrigation District Act told bondholders that the tax deed would transfer an absolute title.

"The deed conveys to the grantee the absolute title to the lands described, etc."

Sec. 48, Cal. Stats. 1917, p. 271.

Why uphold Section 83 where it requires impairing the bond lien without impairing other equal or inferior liens at all?

III.

AS THE R.F.C. DID NOT OWN THE BONDS TAKEN UP IT COULD NOT GIVE THE TWO-THIRDS CONSENT REQUIRED BY SECTION 83(d).

This point was made below. Point 7 reads:

"The Reconstruction Finance Corporation (called herein the R.F.C.), is not and was not an owner of any bonds of the district, or of any interest therein and it was not qualified to give the consent necessary to the enforcement of the district's plan of composition.

The R.F.C. was a mere lender of money to the district." (R. 353.)

Section 83(a) requires that the petition when filed shall show the consent of creditors.

> "* * * *owning* not less than 51 per centum in amount of the securities affected by the plan (excluding, however, any such securities owned, held or controlled by the petitioner)."

Under California law a pledgee does not have title to the pledged property. He has a mere lien. The pledgee's interest may be very small.

> "Pledge is a deposit of personal property by way of security for the performance of another act."
>
> Calif. Civil Code, Sec. 2986.

> "* * * the *lien* of a pledge is dependent upon possession."
>
> Civil Code, Section 2988.

> "There are only two forms of lien which under our law can be created by an assignment of personal property as security for a debt. These are: (1) a pledge; (2) a mortgage," etc.
>
> *Arena v. Bank of America,* 194 Cal. 195, 228 Pac. 441.

At pages 18 and 19 of the petition filed herewith we have mentioned that this district did at first plainly contemplate treating the original bondholders as the persons who would give consent. The escrow instructions given by the bondholder to the depository bank which authorized turning the bonds over to the R.F.C., stated in terms that the bondholder was to be paid in part by a *loan* from the R.F.C. to the district and in part with money provided by the district. Note the escrow agreement (R. 239):

> "* * * it being understood that the amount to be received by you for my account is to be de-

rived *from a loan from Reconstruction Finance Corporation"*, etc. * * * "and that sufficient is to be added thereto from funds on hand belonging to the district, to pay the aforesaid 75 cents on the dollar", etc.

The bank was authorized to hand the deposited bonds over to the R.F.C., which acted through the Federal Reserve Bank in San Francisco, which later collected interest. It is impossible to understand the remarks in the opinion of the trial judge that the R.F.C. became the owner of these bonds under the particular circumstances of this case. His opinion declares this. (R. 72.) Not a single one of the cases cited in the opinion of the trial judge was like this case. In the cases cited the district did not put up any money for the purchase of its bonds. In this case, the new plan was to be carried out through the use of borrowed money and the district's money. The escrow instructions specifically showed that they would constitute the written consents of the bondholder that were to be filed when the district filed its petition under *Section 80,* which law the instructions referred to.

(R. 243, R. 244, R. 237.)

Section 80 was invalidated in the *Ashton* case and this district simply assumed the turn in of these bonds constituted the R.F.C. the owner thereof after it had very plainly had them transferred to the R.F.C. as pledgee. We are not concerned with consents by bondholders who have received new bonds as mentioned in Section 83(j) (added near the end of the Chandler Act on June 22, 1938). These old

bondholders never received "new evidence of indebtedness".

52 Stat. at L. 840, Chap. 575.

Moreover, their consent is not pleaded, but the consent of the R.F.C. is pleaded. (R. 6.)

We assume the R.F.C. is not different from an ordinary person. It is not mentioned in Section 83 as being a lender to which sanctity or exception attaches.

If the mere advance of part of the price of the bonds could have made the R.F.C. the owner, then it would have been the owner if its loan had amounted to but 1% of the bonds.

The bondholders who must consent to the *filing* of the petition and who make up the 51% are owners and it certainly would be unreasonable to assume that the bondholder who joins in giving the ultimate two-thirds consent and who is mentioned in Section 83(d) is a bondholder of a different type. The latter section uses the expression:

> "* * * but excluding claims *owned,* held or controlled by the petitioner, etc."

The loan resolution is literally filled with provisions indicating that a loan was intended. (R. 163 to 192.) But it says (R. 178):

> "All or any part of the Old Securities *acquired or held* by or on behalf of this Corporation through *any* disbursement of or from the loan authorized hereunder as well as all rights in or to such Old Securities, may be kept alive for a greater or lesser time and for any purpose the Division Chief may deem necessary."

But it also said (R. 178, 179):

> "* * * if the Borrower shall, before any new bonds are delivered to this Corporation pay or cause to be paid to this Corporation an amount in cash equal to the disbursements it has made to or for the benefit of the Borrower with 4% interest thereon until paid, this Corporation will thereupon surrender or cause to be surrendered the Old Securities, etc."

One could well say that it is absolutely immaterial whether a loan was or was not intended in the taking up of these bonds because the sole contract that the irrigation district could make with the R.F.C. under which it procured funds from the R.F.C. was a loan contract. A California irrigation district has no powers excepting such as the law confers.

> "Sec. 61. The board of directors of other officers of the district shall have no power to incur any debt or *liability* whatever in excess of the express provisions of this act."
>
> Cal. Stats. 1921, p. 1108.

It is recognized that to enable a California irrigation district to borrow money from the R.F.C. in a refunding plan it would be necessary to add to the existing law. This was accomplished by adding, in 1933, Section 11 to an act adopted in the year 1917.

Said Section 11 contains the following:

> "As evidence of such *loan or loans* and the obligations of such district to repay the same to the United States or any agency thereof, any irrigation district, upon being authorized so to do as provided by section 3 of this act as here-

> inafter in this section modified, may make and enter into contract or contracts with the United States or any agency thereof, as a condition or requirement to the making of *such loan or loans.*"
>
> Cal. Stats. 1933, p. 2395.

Old Section 3 of the act of 1917, referred to in the foregoing quotation provided for elections in making certain other contracts with the R.F.C. if approved at an election.

> Cal. Stats. 1917, p. 243.

Petitioner's Exhibit 15 is the resolution of the board of directors of the district calling the election and the proposition voted upon was whether new bonds would be issued as provided in the R.F.C. *loan resolution* to which we have referred.

The Constitution of the State of California prohibited the district from making a gift. The district could not use its funds in buying up bonds with a view to vesting ownership of the same in another.

> "The legislature shall have no power * * * to make any gift or authorize the making of any gift of any public money or thing of value to any individual, municipal or other corporation whatever"; etc.
>
> Const. Calif. Art. IV, Sec. 31.

This restriction applies to all subordinate political bodies.

> 18 *Cal. Juris.*, p. 1129;
>
> *County of Los Angeles v. Jones,* 6 Cal. (2d) 695, 704;

People v. San Joaquin etc. Assn., 151 Cal. 797;
Johnson v. County of Sacramento, 137 Cal. 204;
County of Sacramento v. Chambers, 33 Cal. App. 142.

The R.F.C. regularly took its interest on its advances. Pages 307 to 313 of the record set out the interest bills and the coupons of the bonds held by the R.F.C. which were turned in. And it was testified that these coupons equal to the amount of the interest were cancelled. (R. 314.)

"Q. At the time you received this bill did you also receive the coupons mentioned on the second sheet?

A. Yes.

Q. And what was done with the coupons which were mentioned on the second sheet?

A. Cancelled."

And yet the trial court found that the R.F.C. remained the owner of the bonds and all coupons for interest falling due after July 1, 1933. The theory of the petition is that those coupons were not cancelled.

We ask that the court shall determine whether under Section 83, a person other than an owner is qualified to give consent.

IV.

IF THE R.F.C. BECAME THE OWNER OF THESE BONDS THIS PLAN WAS DISCRIMINATORY IN THAT IT AND NO OTHER BONDHOLDER WAS UNDER THE DISTRICT'S PLAN OFFERED NEW BONDS PLUS INTEREST AT 4%.

THE DISTRICT NEVER DEPOSITED WHAT IT OFFERED TO THESE DISSENTERS AND IT IS NOT BOUND TO PAY INTEREST TO THE R.F.C. ON WHAT THEY ARE TO RECEIVE. IT HAS NOT AS YET BORROWED THE AMOUNT. THESE DISSENTERS SHOULD BE PAID INTEREST AND NOT BE PENALIZED FOR ASKING TO BE HEARD.

This contention was covered by points 15 and 16 of the statement of points relied on. (R. 354 and 355.) They are accurately summarized in the foregoing heading.

The plan must not discriminate. (See 83(e).)

If the R F.C. was but a pledgee that makes an end of the case for there is no consent. If it owned the bonds which it took up from the depositories, then how can it under Section 83 receive a consideration different from what is to be rendered to the dissenting bondholders. Yet it is to receive interest on its advances at 4% up to the time the plan is effective and is then to receive perfect four per cent bonds for its advances.

(R. 12 and 13.)

No such offer is made to the other bondholders.

There was no evidence the offers were equal.

Section 83(e) says the plan must not discriminate unfairly in favor of any creditor.

The law cannot penalize dissenting bondholders simply because they insisted on having their day in court and this brings up the second phase of this point. Those who accepted the plan were paid off in the early part of 1937. This is shown by the interest bills rendered by the R.F.C. to which we have just been referring. (R. 307 to 313.)

We are penalized simply because we insisted on due process of law, dared to ask a hearing in court. In the meantime the consideration is retained by the district. No tax collection was required in advance and interest was not paid to the R.F.C. until it made its advances. No loan has yet occurred on account of petitioners' bonds.

If the plan had been so utterly fair that any rational human being should have accepted it the case might be different but no bankruptcy law has ever required the acceptance of the plan of composition without according a hearing to the creditor affected. In ordinary bankruptcy the law requires the offers shall be

> "* * * deposited in such place as shall be designated by and subject to the order of the judge."
> Sec. 12, Bankruptcy Act;
> U.S.C. Title 11, Sec. 30.

And application for confirmation can not be made before the consideration is deposited. The debtor may use his credit in providing the consideration so to be deposited.

> *Zaveli v. Reeves,* 227 U. S. 625, 57 L. ed. 676;
> *In re Rubins,* 74 F. (2d) 432.

It is common practice to give notes in part payment of a composition.

In re Carton, 148 Fed. 63;
Wiley v. Brown, 206 Pa. 322, 55 A. 1029.

Here the debtor deposited no funds or notes and did not become obligated to the R.F.C. for a penny of interest until the R.F.C. joined in disbursing money to the accepting bondholder. (R. 10.) To the creditor who asked to be heard the plan meant one thing. To the creditor who would surrender, it meant something else, but there is no legal ground for such distinction.

V.

ALL THE PROPERTY AND THE POWERS OF A CALIFORNIA IRRIGATION DISTRICT ARE GOVERNMENTAL AND HENCE SECTION 83 CANNOT APPLY.

Point 4 read:

> "The court was without jurisdiction, etc. The district is strictly a governmental agency", etc. (R. 352.)

While in *U. S. v. Bekins,* 304 U. S. 27, 82 L. ed. 1137, this court upheld Section 83, it did not have before it the recent ruling that shows that all the property of an irrigation district is public and all its functions are political. It would seem impossible to put a plan into effect against such a district without interfering with state sovereignty. These districts are:

"* * * agencies of the state whose functions are considered *exclusively* governmental, their property *is state owned, held only for governmental purposes;* etc.

El Camino Irr. Dist. v. El Camino Land Corp., 12 Cal. (2d) 375, 85 Pac. (2d) 123;

Anderson-Cottonwood Irr. Dist. v. Klukkert, 13 Cal. (2d) 191, 88 Pac. (2d) 685.

Section 83 states that the court may not

"* * * interfere with (a) any of the political or governmental powers of the petitioner; or any of the property or revenues of the petitioner necessary for essential governmental purposes, etc."

It would seem reasonable to review the *Bekins* case on the basis of the last citation. It is, of course, to be mentioned that the California Supreme Court has declared there is no impediment in these rulings.

Peoples State Bank v. Imperial Irr. Dist., ... Cal. ....., 101 Pac. (2d) 466.

But the question is one for this court. We respectfully contend that it is contradiction in terms to say that determining under the bankruptcy power that this plan shall be enforced is not an interference with the public fiscal affairs and property of the state.

CONCLUSION.

This court should determine:

1. The question as to whether when an irrigation district appeals to a court under Section 83 to have confirmed a plan of composition of bonded indebtedness (which in all honesty is on behalf of landowners) the court may deprive the bondholders of nearly nine-tenths of the security behind their bonds when local law makes such bond security practically perfect if there is a 40% margin. The question as to whether the 5th amendment is violated.

2. The meaning of "fair and equitable" in Section 83.

3. Whether Section 83 requires a less offer because the land is mortgaged.

4. Whether in its application here Section 83 is constitutional.

5. Whether a pledgee of the bonds can give the consent required by Section 83.

6. Whether a plan discriminates that offers one thing to one creditor and something else to another creditor; whether interest should be paid on this district's offer.

7. Whether the bankruptcy court had jurisdiction.

The merit of our cause and the questions of statutory construction involved justify our appeal for a review.

Dated, Berkeley, California,
November 18, 1940.

Respectfully submitted,
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W. COBURN COOK,
Attorneys for Petitioners.

GEORGE CLARK,
Of Counsel.

Due service and receipt of a copy of the within is hereby admitted

this.....day of November, 1940.

.....

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Attorneys for Respondent.